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Supreme Court of the United States

OCTOBER TERM, 1940.

No. 343

In the Matter

of

WISE SHOE COMPANY, INC.,
Debtor.

MOHONK REALTY CORPORATION,
Petitioner-Appellant,

WISE SHOE STORES, INC.,
Appellee.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

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MOHONK REALTY CORPORATION, petitioner-appellant, respectfully prays that a writ of certiorari be issued to review the judgment of the United States Circuit Court of Appeals for the Second Circuit entered in the above cause on the 3rd day of May, 1940, affirming an order of the United States District Court for the Southern District of New York, denying the motion of petitioner (a) to vacate and set aside a certain decree of the District Court, which consummated a plan of reorganization and discharged the above named debtor of its liabilities; (b) to amend the said plan of reorganization to the extent of requiring all unexpired leases of the said debtor, which were not rejected in the reorganization proceeding, to be assumed by Wise Shoe Stores, Inc., the reorganized company (hereinafter called appellee).

Opinions Below.

The opinion of the District Court is to be found at (R. 235). It has not been reported. The opinion of the Circuit Court of Appeals (pp. 88-93) is reported in 111 F. (2nd) 287.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on May 3, 1940. An application for an extension of time within which to file the petition for certiorari until August 16, 1940, was granted by Mr. Justice Reed on August 2, 1940. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925 (28 U. S. C. A. 347).

Questions Presented.

1. Whether a plan of reorganization filed in a proceeding under (former) Section 77-B of the Bankruptcy Act, by a Creditors' Committee, which failed to make provision for the assumption by the reorganized corporation of the unexpired leases which had not been rejected, and which plan did not on its face disclose that it was not intended to have the reorganized corporation assume such leases, is not, as a matter of law, a fraud upon the landlords affected and an invalid plan within the purview of the statute mentioned.

2. Whether, when such an invalid plan of reorganization is confirmed by the District Court in ignorance of the fact that it contemplated a transfer of all unrejected leases to the reorganized company without any obligation on the part of the latter to assume the same, the landlords affected are not entitled, upon discovering the true facts (a) to the absolute right of having the case reopened and the reorganization plan amended to impose upon the reorganized company the duty to assume the un-

rejected leases, or (b) at least to a claim for damages equal to what they would have been entitled to prove for had their leases been rejected before confirmation of the plan.

3. Whether the appropriation by members of a Creditors' Committee for themselves personally and for other members of their class, of all the assets in which other creditors too have a common interest, through the medium of a reorganization plan under Section 77-B, is not such a fraud in law as to entitle the excluded class of creditors, upon discovery of the fraud, to the absolute right of reopening the case and obtaining appropriate relief.

Statute Involved.

Former Section 77-B is involved in this proceeding, particularly the following subdivisions thereof:

Section 77-B (b) (10) (11 U. S. C. A. 207 [b] 10):

"* * * The term 'creditors' shall include for all purposes of this section and of the reorganization plan, its acceptance and confirmation, all holders of claims of whatever character against the debtor or its property, including claims under executory contracts whether or not such claims would otherwise constitute provable claims under this Act. * * *"

Section 77-B (f) (1) (11 U. S. C. A. 207 [f] 1):

"After hearing such objections as may be made to the plan, the judge shall confirm the plan if satisfied that (1) it is fair and equitable and does not discriminate unfairly in favor of any class of creditors or stockholders, * * *."

Section 77-B (f) (7) (11 U. S. C. A. 207 [f] 7):

"Before or after a plan is confirmed, changes and modifications may be proposed therein by any party in interest and may be made with the approval of the judge after hearing upon notice to creditors and stockholders, * * *."

Statement.

Petitioner, on August 18, 1936, leased its premises, known as 11 West 34th Street, New York City, to the debtor, Wise Shoe Company, Inc., for a term beginning November 1, 1936 and ending December 31, 1946, at a rental of $44,000 per annum up to October 31, 1941 and $48,000 per annum for the balance of the term (R. 86).

The debtor was in occupation of these premises and others when it filed its petition for reorganization in the Southern District of New York on August 19, 1938. On that date, Judge Patterson approved the said petition and signed an order continuing the debtor in possession (R. 7). Even before the filing of the said reorganization petition, a so-called Creditors' Advisory Committee had been formed consisting of ten of the largest merchandise creditors (R. 20-21) and representing in excess of 66⅔% in amount of the unsecured claims (R. 11). This Committee retained accountants, attorneys and a secretary and throughout the entire reorganization proceeding took a most active part in the case (R. 21, 47, 62, 168, 219). Indeed, the counsel for this Committee completely dominated and controlled the course followed by the debtor in possession throughout the entire period of the reorganization. Although the Committee was composed solely of merchandise creditors, it did not label itself as a Merchandise Creditors' Committee, but called itself a Creditors' Advisory Committee (R. 21). The attorneys for this Committee also called themselves attorneys for the Creditors' Advisory Committee (R. 47). Throughout the proceedings, the Creditors' Committee purported to act for all the creditors, while its attorneys applied for and received an allowance for their services rendered for all creditors. At no point in the proceedings did the Creditors' Committee or its counsel indicate that it was only

serving the merchandise group and that the landlords were expected to shift for themselves.

Immediately after the approval of the debtor's petition and the entry of the order continuing it in possession, this Creditors' Committee, acting through its counsel, took up with the officers and attorneys of the debtor, the question of retaining or disaffirming the various leases. The debtor was a chain store concern, selling women's shoes and hosiery at retail in its numerous stores. Naturally, the leases of these stores constituted one of its most important assets. In their desire to preserve such of the leases as they considered to be of value for the benefit of any reorganization that might be effected, counsel for the Committee proposed to the debtor that it obtain at once waivers from the various landlords whose leases the committee desired to retain, by which waivers the landlords would give up whatever rights they had under their leases to cancel such leases because of the filing of the reorganization petition by the debtor (R. 200-203). Petitioner was one of the landlords asked to grant this waiver and it did so (R. 177-179).

The debtor made efforts to reorganize, but found itself unable to do so. Finally, its stockholders stipulated that there was no equity in the assets for them (R. 40-41). In order to facilitate a reorganization by the creditors themselves, these stockholders turned over all of their stock to the Creditors' Committee (R. 15).

On October 25, 1938, the Creditors' Advisory Committee decided that the time was ripe to file a reorganization plan and did so. The only paragraph in this plan, dealing with the matter of the leases, is paragraph 5. It was headed "executory contracts" and reads as follows (R. 17-18):

> "All contracts of the Debtor which are executory in whole or in part, shall in nowise be affected by this Plan, except that the Debtor reserves the right

> to disaffirm such of its present outstanding leases as it may deem appropriate in the premises. The said notices of disaffirmances, however, shall be served upon the landlords affected prior to the date fixed for the confirmation of this Plan."

Obviously, the above mentioned proviso was in all respects proper and unobjectionable. It provided that any leases that were to be disaffirmed must be disaffirmed at least ten days prior to the time fixed for confirmation of the plan, thus affording landlords affected an opportunity to prove their claims for damages.

However, some time after this plan had been proposed by the creditors' committee, such committee—for reasons which only became apparent subsequently—decided to shelve it and present a so-called amended plan (R. 22-48).

The amended plan differed from the original plan only in respect of the treatment to be accorded the unsecured creditors and the landlords. Whereas the original plan gave the unsecured creditors an option to take 25% of the amounts of their claims either in cash or in capital stock of the reorganized company, the amended plan eliminated the cash option and required that all creditors take 25% of their claims in capital stock of the new corporation (R. 25, 26, 39).

With regard to the landlords, the amended plan, under the heading "Executory Contracts," contained the following provision (R. 41-42):

> 10. "The Debtor reserves the right to disaffirm all contracts, including unexpired leases, which are executory in whole or in part. The Debtor, however, shall serve such notices of disaffirmance or rejection upon the parties to said contracts or leases at least ten days prior to the date fixed for the hearing of the confirmation of this Plan."

The above paragraph followed a long-winded section numbered 3, containing nine paragraphs and headed

"Means for Execution of Plan." Tucked away in subdivision D of this Section 3, without any distinguishing marks or headings to direct attention to its important contents, there appeared the following sentence (R. 28-29):

> "The Debtor and/or the Debtor in Possession shall likewise assign to the New Corporation, all unexpired leases, except such as may be rejected by the Debtor."

It will be noted that this sentence neither said nor did not say that the assignment of the unrejected leases to the reorganized corporation was to be without assumption of liability. Considering the fact, however, that in Paragraph 10 of the amended plan dealing with Executory Contracts there was reserved to the debtor the right to disaffirm all unexpired leases, right up to ten days before the confirmation of the plan, it is, we submit, perfectly apparent that any landlord reading the plan, and, indeed, even a skilled and experienced lawyer examining it, would have gotten the impression that the plan contemplated that the debtor would either disaffirm the leases it regarded as undesirable and give the landlords their right to file a claim for damages, or else that the unrejected leases would be taken over and assumed by the reorganized company.

At all events, the attention of the District Court was not called to the fact that subdivision (d) of the amended plan (R. 28-29) had been deliberately introduced for the purpose of enabling the reorganized company to take over by assignment about thirty existing leases which had not been disaffirmed, without assuming any liability thereon and without giving the landlords affected any opportunity to file claims for damages when (as later happened) these unrejected leases assigned to the reorganized company were repudiated by the latter.

The merchandise creditors, who constituted the Creditors' Committee which proposed the amended reorganiza-

tion plan, were all manufacturers of either shoes or hosiery and greatly interested in keeping the business of the debtor corporation going so that they could continue to have an outlet for their products. Both the original and amended plans of reorganization contemplated a continuance of the business of the debtor corporation under the auspices and control of these merchandise creditors.

The two largest merchandise creditors in the case were J. A. Izenstatt and Philip W. Lown, who, between them, at the time of the reorganization, held claims totaling $133,741.55 out of total liabilities of approximately $420,000 (R. 146-147). These creditors were on the Creditors' Committee (R. 21, 72, 73). The counsel for the Creditors' Committee, Mr. Trachman and Mr. Mintz, were the personal attorneys of Izenstatt (fol. 155), and it was they who formulated and filed both the original reorganization plan and the amended plan (R. 21, 46, 47). By reason of events which occurred subsequently, but which were obviously planned in advance, Izenstatt and Lown became one-half owners of the reorganized business by buying out, with Mr. Schoen, President of the debtor corporation (now Vice-President of the appellee), and his relatives and friends, the capital stock received by the other creditors on the reorganization (R. 132-133). As one reviews these events, no one can doubt that the amended reorganization plan was deliberately framed as it was to permit these two merchandise creditors, who controlled the Committee, and Schoen, to later take over the assets and business of the debtor corporation free from any liability on the unrejected leases. The record contains abundant evidence to that effect (R. 155, 156; 164-167). First, efforts were made to obtain rent reductions deemed adequate by the Creditors' Committee from the various landlords holding the unrejected leases. All manner of pressure was brought on these landlords to force reductions. When landlords proved recalcitrant and the anticipated damage claims were not too large, the

leases were disaffirmed. Where, however, the resulting damages from disaffirmance were so large as to occasion a question whether the Creditors' Committee would be able to muster the necessary two-thirds in amount of the creditors' claims to obtain approval of its amended plan, the leases were not disaffirmed and the landlords were lulled into the belief that such leases would remain unaffected and would be taken over by the reorganized company. The record contains some rather unsavory recitals touching upon the methods employed by the Creditors' Committee and their counsel in an effort to force rent reductions (R. 156).

At all events, when the Creditors' Committee had exhausted its efforts upon the landlords holding the unrejected leases, steps were immediately taken to obtain confirmation of the amended plan which had then been pending in the Court for over two months. Copies of this plan were mailed to all the landlords, even those who, like the petitioner, had no provable claims which could then be asserted against the debtor. Nothing, however, was told such landlords either in the plan or in any accompanying letter or circular or in any other way that the unrejected leases were merely to be assigned to the reorganized company, but no liability thereunder assumed. When, therefore, the matter came before Judge Patterson for confirmation, none of the landlords holding the unrejected leases put in any appearance for the obvious reason that they did not consider that they had any interest or standing in the proceeding. Judge Patterson was not told that the amended plan, unlike the original plan, contemplated only an assignment of the unrejected leases without any assumption of liability by the corporation. Had he been so told, as he said later in his opinion, he would probably not have approved the plan (R. 245). At all events, no objection was urged against the plan and Judge Patterson approved it. There was thereupon transferred to the appellee, the reorganized com-

pany, all of the assets of the debtor corporation (R. 65-66), including all of the existing leases of the debtor which had not been disaffirmed (R. 66), including the petitioner's lease.

On June 30, 1939, the appellee, together with the debtor, applied to Judge Patterson for an order terminating the reorganization proceeding. They reported that the plan of reorganization had been fully consummated; that the assets of the debtor corporation had been turned over to the appellee; that the capital stock of the appellee had been issued to the creditors; and that "all acts required to be performed by the debtor for itself and as debtor in possession and by Wise Shoe Stores, Inc., to carry the Plan of Reorganization into effect have been completed and are terminated * * *" (R. 72). Upon this *ex parte* petition, Judge Patterson granted an order on June 30, 1939, terminating the reorganization proceeding and closing this case (R. 55-60). Included in this order was a provision discharging the debtor "from all of its debts, claims and liabilities" (R. 59) and restraining all creditors and claimants

> "from pursuing or attempting to pursue, or commencing any suits or other proceedings at law, in equity or otherwise, against Wise Shoe Stores, Inc., or any of the assets or property transferred by Wise Shoe Company, Inc., to said Wise Shoe Stores, Inc., directly or indirectly * * *" (fols. 59-60).

The debtor corporation throughout the whole period of its reorganization paid full rent to the landlords with the unrejected leases, so that, at the time of the hearing on the confirmation of the amended plan, none of such landlords was in a position to file a claim for damages based upon a disaffirmance or rejection of its lease, nor assert that it was a creditor with a perfectly provable claim.

After the confirmation of the amended plan, the appellee for a time continued to occupy the various prem-

ises covered by the unrejected leases and to pay the full rent due thereunder. After the order terminating the proceeding had been approved, however, and in the month of October, 1939, counsel representing the appellee approached the petitioner and stated that unless a reduction in rent regarded as suitable by the appellee was immediately granted, the appellee would move out (R. 97). When petitioner remonstrated that such removal could not be legally accomplished without subjecting the appellee to damages, the reply was made that under the amended reorganization plan which had been effected, the appellee had taken over the leases only by assignment and had assumed no liability whatever thereon, and that, therefore, the appellee could move out without subjecting itself to any damages (R. 98-99). The Fulton & Elm Leasing Co., another landlord, was given the same ultimatum (R. 167-168). These ultimatums were carried into effect and, soon after the reorganization had been completed, the reorganized company removed from petitioner's premises and completely repudiated petitioner's lease with the debtor. It did so on the theory that it was merely an assignee of the lease and that only privity of estate existed between it and the petitioner, which privity of estate was terminated when it removed from the premises.

An investigation by petitioner and other landlords then disclosed that the sponsors of the amended reorganization plan had in fact succeeded in obtaining approval of a plan which enabled the appellee to throw overboard all or any of the leases taken over by it with complete impunity on its part. By the time this discovery was made, petitioner, of course could no longer file any claim for damages in the reorganization proceeding or receive redress for the injuries which it was certain would be sustained upon the repudiation of its lease. There was, therefore, no course left open but to present the matter to Judge Patterson and to move before him for a reopening of the reorganization proceeding and for a modification of the decree ap-

proving the reorganization plan to the extent of requiring the appellee to assume all of the leases taken over by it which had not been previously disaffirmed, or for such other relief as the Court could grant (R. 79-83).

On the hearing before Judge Patterson, petitioner claimed that the plan or reorganization was inequitable and fraudulent as a matter of law, if not in fact, for failing to provide *pro rata* distribution of the assets of the debtor among all creditors on an equal footing. Petitioner also claimed that the Creditors' Committee and its counsel having purported to act for all creditors, owed, as a matter of common honesty and trust, the duty of disclosure to the Court that one class of creditors, viz.: landlords, were not being provided for. Petitioner urged that this duty should have been particularly observed in this case because the members of this Committee obviously stood to gain an advantage for themselves by excluding the landlords with the unrejected leases from participating with them in the reorganization and for the further reason that certain members of the Committee had joined with relatives and friends of the debtor's President to purchase all of the assets of the reorganized company, and that these assets were manifestly worth far more when acquired free from any obligation to landlords.

In opposition to petitioner's motion, the appellee offered no defense whatever based either upon the propriety or the fairness of the amended plan. Not the slightest attempt was made to defend the ambiguous and evasive language in subdivision (d), which gave the reorganized company the right to take over all of the assets, including the unrejected leases, without, however, assuming any liability upon these leases. The only defense appellee did offer before Judge Patterson was that a copy of the amended plan had been sent to all of the landlords, including the petitioner, and that they should have been alert and vigilant enough to detect from the language of subdivision (d) that the reorganized company was not

planning to assume any liability on the unrejected leases; also that if such landlords failed to understand or to detect the true meaning of subdivision (d), the fault was their own. The appellee argued further that the reorganization proceeding should not be re-opened for the reason that certain persons had invested new money in the business following the approval of the plan and that they would be prejudiced by the imposition of new liabilities upon the appellee.

Although it was shown that the so-called new investors in the appellee were Izenstatt and Lown (members of the Creditors' Committee), who between them contributed 50% of the new money, and relatives and friends of Mr. Schoen (the former President of the debtor corporation and now the Vice President of the appellee corporation), who between them contributed the remaining 50% (R. 130-133), and although it was also shown that the amount of assets which the appellee took over from the debtor corporation aggregated more than $500,000 in excess of the total liabilities of the debtor corporation (R. 49-54), whereas the total new capital alleged to have been contributed amounted to only $150,000 (R. 133), Judge Patterson denied the motion of petitioner to vacate the decree approving the amended re-organization plan upon the sole ground that it would be inequitable as against those who had invested the new money in the interval between the confirmation of the reorganization plan and the making of petitioner's motion to saddle new liabilities upon the appellee (R. 246). Judge Patterson did, however, state that the amended plan "was unfair to lessors and unduly favorable to general creditors in not requiring that the new company assume all liabilities of the debtor under the leases to be assigned" (R. 245). He further said that if petitioner had made seasonable objection, such objection would probably have been sustained and the plan amended or modified accordingly (R. 245).

Petitioner took an appeal to the Circuit Court of Appeals for the Second Circuit from this decision of Judge Patterson, and that Court, in a decision written by Judge Clark, affirmed the ruling of the lower court (pp. 88-93). Judge Clark seemed to base his decision upon the ground that the petitioner's application to re-open was addressed to the discretion of the District Court and that there was no abuse of discretion on the part of Judge Patterson in refusing to reopen (p. 90).

We express the hope that this Court will not dispose of our application on the theory that it presents nothing more than an attempt to obtain a review of a motion involving a mere exercise of discretion by the District Court. A fair reading of the papers will, we believe, satisfy this Court that our application involves far more than that. It deals with nothing less than the preservation of honesty and fairness in reorganizations carried on in the federal courts. Furthermore, it presents squarely the issue whether creditors' committees which attempt such reorganizations on their own behalf are to be permitted, by sharp dealing or other objectionable methods, to obtain approval of reorganization plans which give them the assets and leave empty-handed landlords with unrejected long term leases.

Specifications of Errors to be Urged.

The Court below erred

(1) in affirming the order of the District Court;

(2) in failing to hold that the amended plan of reorganization, which Judge Patterson approved without knowing that it made no provision for the landlords holding unrejected leases, was fraudulent as a matter of law and entitled petitioner upon discovering the true facts to have the case reopened and the reorganization plan modified, so as to make the same provision for landlords as was made for other creditors;

(3) in holding that the petitioner and other landlords with unrejected leases were bound by the reorganization plan, simply because a copy thereof was sent to them in the mail, even though this plan made no provision for them and did not fully and fairly apprise them that their leases could be later disaffirmed without liability on the part of the reorganized company;

(4) in holding that the plan itself contained a notice of rejection or operated as a rejection of petitioner's lease and thus conferred upon petitioner the status of a creditor with a provable claim entitling it to be heard in opposition to the plan;

(5) in failing to hold that this case falls within the doctrine of *Kansas City Railway* v. *Guardian Trust Co.*, 240 U. S. 166, where this Court held that a plan of reorganization, which did not on its face give notice of an intent to prefer a certain group of security holders over others having a paramount position by law, was not binding on the latter, even though they assented to the plan;

(6) in failing to grant petitioner relief at least to the extent of vacating the stay contained in the order of June 30, 1939 (R. 55-60) enjoining petitioner from commencing any suit against the debtor or from following any of its assets into the possession of the reorganized company;

(7) in holding that the question involved herein was merely one of discretion and also in holding that there was no abuse of discretion in denying petitioner's motion to reopen the reorganization proceeding;

(8) in failing to hold that the Creditors' Committee, which framed and obtained approval of the reorganization plan in this case, had no right to utilize its position of trust for the purpose of obtaining an unfair advantage for its members and the other creditors at the expense of landlords.

Reasons for Granting the Writ.

This is the first case which we have been able to find since the enactment of Section 77-B of the Bankruptcy Act where a reorganization plan was deliberately framed to permit one group of creditors to take over the business of the debtor corporation and continue it for their benefit, free from any liability to landlords who held unrejected leases. A similar scheme was attempted under the old-fashioned equity receivership practice which prevailed prior to Section 77-B, in the case of *Howard* v. *Maxwell Motor Car Co.*, 269 Fed. 292, affirmed 275 Fed. 52. There the scheme was strongly condemned by the Second Circuit Court of Appeals and the landlord affected was left free to pursue his common law remedies and to follow the assets of the debtor corporation into the hands of the reorganized company. Manifestly, the questions presented by this application are of such far reaching importance in the field of reorganization law, that they transcend in importance the immediate issues in this case. If the decision below is allowed to stand, it will furnish a most dangerous precedent whereby sponsors of reorganization plans, by the use of adroit and equivocal language in the plans, can manoeuver landlords and other classes of creditors into a position where they are deprived of all opportunity to participate in the avails of the reorganization.

The fundamental question which permeates this entire case is whether a reorganization of an insolvent corporation under Section 77-B or under the successor statutes is to be permitted, by which a certain group of creditors take over all of the assets and the benefits which go with those assets, without assuming the burden of the contracts and leases which have not been rejected in the reorganization. Stated in another form, this question is whether the processes of the District Courts are to be permitted to be invoked not for the purpose of enforcing

or protecting the rights of all creditors, but merely to defeat the rights of certain of such creditors.

We will deal now with the specific reasons for granting the writ asked for in this case:

1. The holding of the Court below conflicts with the applicable decisions of this Court, which hold that community of interest involves mutual obligations and that one group of stockholders or creditors cannot appropriate all the property of a reorganized company to the exclusion of another group (*Southern Pacific Co.* v. *Bogert*, 250 U. S. 483, 492; *Jackson* v. *Ludeling*, 21 Wall. 616, 622). The doctrine of the two cases just mentioned is particularly applicable here, because it was chiefly the members of the creditors' committee who benefitted from their own breach of trust and wrong.

The landlords in his case were fully justified in believing that the creditors' committee, which purported to represent all creditors, would obey the law and refrain from proposing or submitting to the Court a plan known by it to be unfair or inequitable as against other groups of creditors (*Central Improvement Co.* v. *Cambria Steel*, 210 Fed. 711, affirmed *sub nom. Kansas City Railway* v. *Guardian Trust*, 240 U. S. 166; *Louisville Trust Co.* v. *Louisville, etc., Ry.*, 174 U. S. 674, 686-687). So too were such landlords, when their leases had not been rejected up to the time of the hearing on the reorganization plan and when nothing in the plan made any mention about such unrejected leases not being assumed by the reorganized company, warranted in believing that they were not to be affected and that, therefore, there was no need for them to make an appearance before the Court to oppose the plan. No reported case that we are aware of holds that landlords with unrejected leases, for whom no provision is made in the plan and who are not apprised by the plan that they are to be in any way affected, are bound to subject the plan to a microscopic examination and analysis, so as to be entirely certain

that there does not lurk therein some equivocal language permitting the sponsors of the plan to accomplish an illegal result.

2. The Circuit Court of Appeals has decided an important question of Bankruptcy Law contrary, we think, to the decision of this Court in *Kansas City Railway Co.* v. *Guardian Trust Co.*, 240 U. S. 166.

That case holds that a creditor who assented to a plan of reorganization was not bound by it when the plan did not, on its face, show an intent to prefer the stockholders and leave the unsecured creditors inadequately provided for. In the instant case, the Circuit Court of Appeals has decided that the petitioner was bound by the amended reorganization plan, even though this plan did not disclose on its face that landlords with unrejected leases were not to be provided for and even though the petitioner did not assent thereto. The decision of the Circuit Court of Appeals is also opposed to the *Kansas City* case in that there the creditors affected were permitted to pursue their common law remedies against the property of the insolvent corporation which had been transferred to the reorganized company. In the instant case, the Circuit Court of Appeals refused to vacate the stay which the District Court had granted against all creditors and landlords, enjoining them from suing either the debtor corporation or from following its assets. In that respect the decision of the Circuit Court of Appeals is also squarely opposed to a decision of the same Court in *Howard* v. *Maxwell Motor Car Co., supra.*

3. The Circuit Court of Appeals has decided an important question of law contrary, we think, to the decision of this Court in *Linn Timber Co.* v. *U. S.*, 236 U. S. 574, 577, 578, and contrary also to a decision of the Ninth Circuit Court of Appeals in *Wilson Coal Co.* v. *U. S.*, 188 Fed. 545, 549, which was cited as decisive in *Linn Timber Co.* v. *U. S., supra.* The Circuit Court of Appeals, in the

instant case, following the ruling of the District Court, held that petitioner's motion to re-open the reorganization proceeding should not be granted because, after the consummation of such reorganization, some new capital had been invested in the reorganized company. It so happens, as we have already pointed out, that 50% of the new capital just referred to came from two of the merchandise creditors who were members of the very committee which obtained approval of the reorganization plan now under attack, and the other 50% came from the family and relatives of the former President of the debtor and now Vice-President of the appellee. Thus, the ruling below permits the very parties responsible for the fraud to set up their own investment as a shield against attack. This Court and the Ninth Circuit Court of Appeals, in the two cases cited above, held that a corporation, which has taken over property with knowledge that certain outstanding equities exist in favor of creditors, cannot defend against such creditors by showing that its stockholders subscribed to or purchased their stock in good faith and in ignorance of the claims of the attacking creditors. Furthermore, this Court in *Kansas City Railway* v. *Guardian Trust Co., supra,* permitted creditors, for whom adequate provision had not been made in the reorganization, to proceed against the assets held by the reorganized company, notwithstanding that new money had been invested in that company on the basis of the decree approving the reorganization. And the law on this subject expounded by the State Courts of New York also seems to be opposed to the ruling of the Circuit Court of Appeals below. (See *Hurd* v. *N. Y. & C. Steam Laundry Co.*, 167 N. Y. 89; *Wilson* v. *Aeolian Co.*, 64 App. Div. 337, affirmed 170 N. Y. 618.)

4. If the decision of the Circuit Court of Appeals is allowed to stand, the manifest requirements of Section 77-B (f) (1) (now Section 221 [2]) that a plan shall not

be confirmed unless it is fair and equitable and does not discriminate unfairly in favor of any class of creditors or stockholders, will be rendered completely ineffectual. What the Circuit Court of Appeals did in this case was to condone a plan which was admittedly unfair to landlords merely because the parties who sponsored it were not caught before the plan was consummated and because these parties either invested or induced others to invest new capital in the reorganized corporation.

Unless the decision of the Circuit Court of Appeals herein is reversed, the device which was successfully employed in this case by the creditors committee will become an authoritative precedent for future plans of the same sort. Not only will this precedent serve to make possible the consummation of reorganization plans which violate the plain intendment of the statute, but it will also place a premium upon sharp dealing on the part of debtors or committees and upon the dispatch with which unfair, inequitable and illegal plans are railroaded through by sponsors who are in control at the time. If sponsors of plans of reorganization know that the statutory requirements of fairness and non-discrimination will be enforced only when the Court or the creditors to be affected are sufficiently alert to discover the unfairness or discrimination attempted by a particular plan before confirmation is had, the temptation to evade the statute would be very great indeed. Such sponsors will know that they have nothing to lose by venturing an illegal plan and that the worst that can happen is that if the illegal features are discovered, the plan will be disapproved and amended. On the other hand, if these sponsors know that a plan which fails to comply with statutory requirements for equality of treatment and which accomplishes a wrong forbidden by the statute will not stand, even though confirmation is obtained through the failure of the Court or others affected to detect the illegality intended, and even though new capital may be brought into the business,

then we may be certain that attempts to railroad through an illegal plan such as was done in this case will be abandoned.

5. One of the issues raised by the decision of the Circuit Court of Appeals presents an important question of Federal Law, which as yet has not been authoritatively settled by this Court. That question is whether a landlord with an unrejected lease can be effectively barred from participating in the reorganization through the mere failure to provide for him in the reorganization plan. In an article written by Professor Douglas (now Mr. Justice Douglas of this Court) in collaboration with Mr. Jerome N. Frank, the present Chairman of the Securities and Exchange Commission, in 42 Yale Law Journal 1003, the following terse and succinct statement of the law is made (p. 1009):

> "The assumption that he can be effectively barred through reorganization plans by mere failure to provide for him cannot be sustained. If the reorganization managers do not extend to him the same protection as is extended to other creditors, they proceed at the risk of the new corporation being liable to the landlord as, if and when his claim matures and become liquidated. This result is obvious if the landlord has a claim which is provable in bankruptcy or receivership. It is equally true though the landlord has no claim satisfying the standard tests of provability, for he is entitled to participation under such reorganization plan despite the fact that at the time of the consummation of the plan by a sale of the assets to a new company his claim is wholly contingent."

The conclusion reached in the article just cited is not only in accord with the statutory requirement of Section 77-B and the present Chapter X of the Bankruptcy Act, but also reflects the judicial conception of fairness and non-discrimination in a reorganization as enunciated in a long line of authorities, many of which have been cited in this petition.

6. The holding of the Circuit Court of Appeals below that the very plan of reorganization in the instant case contained notice of rejection or operated as a rejection of the petitioner's lease and thus conferred upon petitioner the status of a creditor, entitling it to be heard in opposition to the plan, is contrary to the decision of the Circuit Court of Appeals for the Fourth Circuit in *Consolidated Gas Elec. L. & P. Co.* v. *United Rys. & Elec. Co.*, 85 Fed. (2nd) 799, cert. den. 57 Sup. Ct. 493. In that case, the Fourth Circuit Court of Appeals held that if an executory contract is to be rejected on behalf of a debtor in a reorganization proceeding, it must be done in a manner and at a time to give the other contracting party the status of an unsecured creditor and also that the right of rejection must be exercised in the plan or before the plan is confirmed. In the instant case, manifestly, the right of rejection was not exercised in the plan or prior thereto. An attempt was made to reserve such right of rejection for the reorganized company, to be exercised after the reorganization and at a time when the petitioner could not assert a claim or be heard in opposition to the plan.

7. The holding of the Circuit Court of Appeals below was that petitioner's application to reopen the reorganization proceeding or for other relief, such as pursuing the assets of the debtor corporation in the hands of the reorganized company, should be barred because no actual fraud was shown. This is not only erroneous, but conflicts with the applicable decisions of this Court (*Southern Pacific Co.* v. *Bogert, supra; Jackson* v. *Ludeling, supra; Central Improvement Co.* v. *Cambria Steel Co.*, affirmed *sub nom. Kansas City Railway* v. *Guardian Trust Co., supra; Howard* v. *Maxwell Motor Co., supra*).

The cases just cited establish that it is a fraud as a matter of *law* for a reorganization plan to fail to make equal provision for creditors on the same footing. Admittedly, the reorganization plan in the instant case not

only failed to make equal provision for the merchandise and the landlord creditors, but made no provision whatever for the landlord creditors with the unrejected leases and brazenly provided that all of the assets *in toto* were to go to the merchandise creditors, who alone were to receive the stock of the reorganized company. In *Northern Pacific Co.* v. *Boyd,* 228 U. S. 482, this Court, in allowing the plaintiff to pursue his common law rights against the assets which were transferred to the reorganized company, said that if actual fraud had to be shown before equitable relief could be given, then the creditors' legal rights would depend upon the motive with which organizers act and the method by which they carry out their scheme. In that case, this Court held that although the reorganization plan was "free from any moral or actual fraud" (p. 502), a contingent creditor, for whom no provision had been made, was nevertheless entitled to subject the interest which stockholders had obtained to the payment of their claims. And in the case of *Howard* v. *Maxwell Motor Co., supra,* as we have already pointed out, the Second Circuit Court of Appeals also permitted the landlord, who had not been provided for in the reorganization, to follow the assets held by the reorganized company, in spite of the fact that it found no actual fraud. And in the later case of *In re Alamac Operating Corp.,* 42 Fed. (2) 120, the same Court again ruled that the State of New York, whose claims had not been provided for in the equity receivership reorganization, was not bound by such reorganization and was therefore entitled to assert its claim against the new reorganized company and its assets. In the instant case, as we have mentioned, not only did the District Court and the Circuit Court of Appeals decline to allow a reopening of the reorganization, but even declined to accord petitioner the right to pursue his common law remedies against the assets held by the reorganized company.

In the cases of *Southern Pacific Co.* v. *Bogert* (at page 492), and in *Jackson* v. *Ludeling* (at page 634, *supra*), this Court pointed out that the fraud involved was outside the record and that the forms of law were scrupulously observed, but that the wrong lay in refusing to make *pro rata* distribution of the corporate assets upon equal terms to those entitled to it, for which reason the reorganization plans could not stand against those who were wronged thereby.

We submit that the decision of the Circuit Court of Appeals in the instant case circumscribing and limiting its own power to redress the wrong to the petitioner because of the absence of what it calls actual fraud, is not only erroneous, but wholly undesirable from every standpoint.

Conclusion.

It is respectfully submitted that this petition for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit should be granted.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 343

IN THE MATTER

OF

WISE SHOE COMPANY, INC.,

Debtor.

MOHONK REALTY CORPORATION,

Petitioner-Appellant,

WISE SHOE STORES, INC.,

Appellee.

BRIEF FOR APPELLEE IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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IN THE

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OCTOBER TERM, 1940.

No. .....

In the Matter

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WISE SHOE COMPANY, INC.,

Debtor.

MOHONK REALTY CORPORATION,

Petitioner-Appellant,

WISE SHOE STORES, INC.,

Appellee.

BRIEF FOR APPELLEE IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

STATEMENT.

Petition for writ of certiorari to review a judgment entered May 3, 1940, by the United States Circuit Court of Appeals, Second Circuit, affirming an order, dated December 14, 1939, made by Hon. Robert P. Patterson, United States Circuit Judge, sitting in the United States District Court, Southern District of New York, denying appellant's motion (a) to vacate and set aside the final decree of the District Court dated June 30, 1939, in the reorganization proceedings herein; and (b) amending the

plan of reorganization by requiring the reorganized corporation to assume all unexpired leases of the debtor which were not rejected.

CRITICISM OF QUESTIONS PRESENTED BY PETITIONER.

While contending that there are no questions requiring a review by this court, we, nevertheless, wish to point out that the questions presented by petitioner (petition, pp. 2-3) are based on false premises. Question (1) assumes that the amended plan of reorganization did not "on its face" disclose that the new corporation, appellee, was not to assume unrejected leases. It will be shown herein that this is not so and that that fact was apparent from the plan. Question (2) assumes the invalidity of the plan and the "ignorance" of the District Court of the foregoing provision when the plan was confirmed, neither of which hypotheses we will show to be well-founded. Question (3) will likewise appear to be without substance as the facts are unfolded, and that there was neither fraud nor misappropriation of assets.

FACTS.

The statement of facts in the petition is so replete with unsubstantiated charges and statements both *dehors* and in contradiction of the record, that an accurate summary of the facts as they appear from the record becomes necessary.

A petition for reorganization under former Section 77B of the Bankruptcy Act was filed in the District Court on August 19, 1938, and was approved by order dated the same day (R. 3).

On October 25, 1938, a plan of reorganization (R. 2-7) was filed and in January, 1939, an amended plan (R.

8-18) was filed by a committee usually labelled by itself (R. 9, 10), its attorneys and the court (R. 19) and petitioner and its counsel (R. 27, 29, 30, 46, 48 and 53) as the Merchandise Creditors Advisory Committee, which committee was denominated by the court as "a" creditor's committee (R. 79). In fact, in petitioner's brief to the Circuit Court it referred at page 5 to "the merchandise creditors, who constituted the Creditors' Committee," and did not argue, as it does now (petition p. 4), that the committee "purported to act for all the creditors". (This recital does not constitute the slightest concession as to the validity of petitioner's criticism of the committee, but it demonstrates, by way of illustration, the unreliability of such purported statements of fact in the petition as that on page 4 wherein the petitioner says, "Although the Committee was composed solely of merchandise creditors, it did not label itself as a Merchandise Creditors' Committee, but called itself a Creditors' Advisory Committee".)

The amended plan was confirmed on April 3, 1939 (R. 21) and the final decree terminating the proceeding and closing the case was made on June 30, 1939 (R. 19-20).

The confirmed plan proposed that a new corporation be formed to which all the assets of the debtor should be transferred (R. 9) and that

> "The debtor and/or the debtor in possession shall likewise assign to the new corporation, all unexpired leases, except such as may be rejected by the debtor" (R. 10).

The plan (R. 8-18) was brief and simple. It described the assets of the debtor to be assigned to the new corporation (R. 9-10), including unrejected leases, vested the same in the new corporation free of claims or liens not

"expressly provided in this Plan" (R. 10) and expressly enumerated the claims to be assumed by the new corporation (R. 11-13), and it reserved to the "Debtor" the right to disaffirm executory contracts, including unexpired leases, on ten days notice prior to the hearing on confirmation of the plan. It did not provide that such contracts not rejected by the debtor, but assigned by it to the new corporation, were to be assumed by the new corporation, and, as stated, the new corporation was to be liable only for obligations expressly assumed and enumerated under the plan.

All the stock of the new corporation was to be issued to the creditors of the debtor (R. 39); *the stockholders of the debtor were to receive nothing* (R. 14). This plan was fully executed and the final decree followed (R. 19-20).

The final decree enjoined creditors, claimants and stockholders from proceeding against the new corporation or the assets transferred to it, except as to such liabilities and claims expressly assumed by the new corporation (R. 20).

Prior to the reorganization proceeding, and on August 18, 1936, petitioner leased certain premises to the debtor for a ten year term (R. 29).

At the time of the reorganization this lease was in effect. The petitioner formally appeared in the proceeding (R. 81) and on September 9, 1939, petitioner waived the right to terminate the lease (R. 58-60). Several *ex parte* applications were made to the court to extend debtor's time to disaffirm the lease in question (R. 31, 52).

In March, 1939, petitioner moved the court, by David W. Kahn, Esq. (who is still representing petitioner on

this application) to compel the debtor in possession to pay rent (R. 52). Mr. Kahn was at all times familiar with the amended plan of reorganization and of all the steps taken in the proceeding (R. 42). In fact he was counsel for the debtor (R. 66, 67, 71-73) and took active part in discussions concerning the leases (R. 68-69).

Petitioner received all notices in the proceedings; it received notice of approval of the amended plan together with the amended plan and a form of acceptance; it received notice of the hearing on the confirmation of the amended plan (R. 38-39).

The lease in question was not rejected (R. 31) but in accordance with the terms of the amended plan (R. 10), was assigned by the debtor to the new corporation (R. 22).

After confirmation, but before final decree, I. Alfred Levy, on behalf of a client who was interested in purchasing the stock of the new corporation, investigated the business of the corporation and the reorganization records (R. 37-38). He ascertained that the leases (including the one in question) had been assigned to, but not assumed by the new corporation (R. 38).

Thereafter, his offer to purchase the stock of the new corporation was made and accepted (R. 39-40) and accordingly Mr. Levy's clients invested approximately $225,000 in cash (R. 41), of which sum of $141,000 was paid into the treasury for working capital, for which a second preferred stock was issued; $45,569.35 was paid to the voting trustees for the benefit of most of the former creditors of the debtor corporation who held voting trust certificates issued to them under the plan, in satisfaction of their claims, while the few remaining creditors elected to take first preferred stock amounting to $39,000 in the

new corporation (R. 40). Those creditors who elected to take cash received 20% of the amount of their claims against the debtor (R. 49). One-half of this investment was made by two former creditors of debtor and one-half by thirteen others (R. 81, 39-40).

This investment of new money was made in reliance upon the decree and the order confirming the plan (R. 41) and further upon the fact that the leases had not been assumed by the new corporation (R. 38, 82). This is not disputed (R. 82).

On August 9th, 1939, Mr. Kahn (of counsel herein for petitioner) communicated with one of the voting trustees and directors of the new corporation and inquired whether the leases had been assumed by the new corporation, but was advised by said trustee that he had no information concerning the leases (R. 63, 77).

In October, 1939, there were discussions between the petitioner and appellee concerning a rent reduction and petitioner was advised that unless a reduction was made, appellee would be compelled to remove from the premises (R. 33).

Thereafter, by notice of motion dated November 9, 1939, petitioner moved the court below for an order vacating the final decree and amending the order of confirmation by providing that the appellee assume all leases not rejected in the proceeding (R. 27-28).

From the order denying such motion (R. 83-84) petitioner appealed (R. 93-94) to the Circuit Court, which unanimously affirmed the decision of the District Court (R. 93-94).

ARGUMENT.

The record does not justify petitioner's assertions (petition, p. 14) that this application goes to the roots of the preservation of honesty in reorganizations and involves fundamental questions regarding the methods of sharp dealing creditors' committees, which assertions petitioner seeks to use as a lever to obtain a review by this court of what actually involved no more than a simple question of judicial discretion.

1. The record does not show that the plan was tainted with fraud.

Petitioner moved in the District Court on the theory that the omission from the plan of a provision for assumption of leases by the new corporation was a fraud upon it and upon other lessors. The record is barren of any proof of fraud. Aside from petitioner's mere unsubstantiated assertions of fraud the facts are: Petitioner, who filed a formal notice of appearance in the proceeding (R. 81) and who waived its right to terminate the lease and come in as a creditor, and who moved in the proceeding to compel payment of rent (R. 31, 52), and who received notice of all steps in the proceeding as well as a copy of the plan of reorganization and the notice of the hearing to confirm the plan (R. 38-39), and who stood by and allowed confirmation without objection, and who without complaint watched the plan consummated, and who knew that a substantial amount of new money was being invested by third parties (R. 42)—now claims that it was lulled to sleep while this alleged ruse was inserted into the plan; and now claims that a fraud was perpetrated because the plan provided for an assignment of its lease, but not an assumption thereof.

Petitioner claims that the provision concerning the leases was "tucked away" in the plan. There is, however, no assertion that the plan was not legible or that the provision in question was in fine type. The record contradicts the charge that one interested in guarding the rights of a landlord would overlook the provision as to leases. This is particularly so when, as above shown, the plan specifically set forth just what obligations were to be assumed by the new corporation, which did not include the leases. It is ridiculous to assume that an interested party would fail to scrutinize the plan to see exactly how it affected him. No duty is imposed on the proponents of the plan to point out to each interested party the particular provision concerning him. An interested party, placed on notice, can hardly take the position of a trusting innocent and avoid the consequences of its own inexcusable negligence, if it were negligence, by crying fraud. The record shows that petitioner made a bargain which it now regrets and from which it seeks to escape by alleging, but not proving, fraud.

It would indeed create a serious situation if any party to a reorganization, finding itself in a position which it did not contemplate, or finding that it made a poor bargain, could later come in and vacate the final decree and amend the plan. If that were so, it would be dangerous to deal with a reorganized corporation. It would be impossible to obtain new investments. The reorganized company would have a sword of Damocles constantly over its head. This court should not sanction any such notion. A final decree should be vacated and a case reopened only upon a positive showing of fraud. No such showing has been made here.

2. The motion to vacate the final decree was addressed to the sound discretion of the District Judge and should not be disturbed unless abuse of discretion is shown.

Judge Patterson found that

> "There is nothing to show the existence of a deliberate scheme to defraud or cheat lessors" (R. 82).

The Circuit Court of Appeals likewise found that there was no fraud, stating:

> "There is also a claim of fraud, which was overruled by the district court. Even if a creditor has an absolute privilege to reopen a bankrupt estate for fraud, and even if the denial of such a motion is fully reviewable on the merits, we are satisfied that no actual fraud has been demonstrated" (R. 92).

It has been held that the reopening of an estate is a matter of sound judicial discretion. *In Re Schreiber,* 23 F. (2d) 428, 430 (Cert. denied 277 U. S. 593); *In re Ferribee,* 7 Cir. 93 F. (2d) 262; *Oehring* v. *Fox Typewriter Co.,* 272 F. 833, 835 (C. C. A. 6); *In re Pilsner Brewing Co.,* 79 F. (2d) 63, 68 (C. C. A. 9).

Judge Patterson was fully familar with every phase of this proceeding. There is no basis for petitioner's assertion that the judge was in "ignorance" of the provisions in the plan for an assignment of leases without an assumption thereof by the new corporation. The judge himself merely stated that petitioner had made no objection thereto (R. 82). He was in the best position to determine whether there was any scheme to defraud or cheat lessors, as is charged by petitioner, and in the ab-

sence of any showing of an abuse of his discretion, his decision should not be disturbed.

The answer to petitioner's argument that it had no standing to file a claim or to appear and be heard is, first, that it deliberately waived its right to terminate the lease and file its three year claim (R. 58-59), and second, it in fact did appear in the proceeding, did receive a copy of the plan, did receive notice of the confirmation (R. 48-49), and could have objected. It chose not to do so.

The Circuit Court of Appeals in its opinion of affirmance stated (R. 93):

> "A landlord is entitled to insist that his lease be either rejected or fully assumed under the plan, and he must appear in the reorganization court at the confirmation hearing or before, in order to assure adequate protection for his interests. • • • Having failed to protest, appellant is bound as a 'creditor' by the order confirming the plan • • • its only avenue of relief was to persuade the district court that it would not be unfair to reopen the plan. That avenue is now closed."

3. The record does not show the plan of reorganization to be unfair or inequitable as a matter of law.

No inferior rights were given preference. Stockholders received nothing in the reorganization (R. 14). All *creditors* were treated alike, but petitioner was not a creditor since its lease was never rejected. It cannot complain that it was to be treated on a parity with other creditors. If petitioner argues that the plan is unfair in that by failing to reject the lease petitioner was prevented from filing its three year claim and that by

assigning the lease to a corporation that did not assume it the debtor was able to rid itself of the lease without paying any compensation, the answer has been given by the Circuit Court of Appeals in the portion of its opinion just quoted. The answer to this argument also is that petitioner had the right to terminate the lease under its terms and to file its claim, which it did not do.

In any event, the petitioner had the right to make an election: it could declare the lease terminated by the 77B proceeding and come in as a creditor just as other landlords did in this very proceeding. (See: *In re Wise Shoe Co.*, 26 F. Sup. 762). Filing of the petition was an admission of insolvency. (*In Re Walker*, 93 F. [2d] 281, 2nd cir.; *In re Wil-low Cafeteria*, 95 F. [2d] 306, 2nd cir., Cert. denied, 304 U. S. 567.) Accepting any rent from the receiver, trustee or debtor in possession did not waive the right to terminate (*In re Walker, supra; Moore* v. *Risley*, 287 F. 10, 9th cir.; *Sproul* v. *Help Yourself Shoe Co.*, 16 F. [2d] 554, 3rd cir.; *Model Dairy Co.* v. *Foltis-Fischer*, 67 F. [2d] 704, 2nd cir.). Or the petitioner could waive the breach of condition, and take his chances that the new corporation would successfully continue the business and continue to pay rent. Petitioner chose to waive the right to re-enter together with the right to file a claim for damages (R. 58-59).

Petitioner made a business decision which apparently it now regrets. It has failed to show that the plan is not fair and equitable.

4. The question as to fairness cannot properly be raised by this petition.

Under any circumstances, the proper procedure to review the fairness or equity of a plan is by appeal from the order of confirmation. In all cases we have examined

wherein this question was raised, objection was taken to the plan and the aggrieved parties appealed from the order of confirmation.

But this petitioner made no objections to the confirmation of the plan despite the fact that it was a party to the proceeding (R. 82), and had received notice of all steps in the proceedings including the hearing on the confirmation of the plan (R. 38-39).

The petition does not involve an appeal from an order of confirmation or a final decree—but an appeal from an order denying a motion to vacate the final decree. One who had notice of the proceedings, and who could have properly raised the question at the hearing on the confirmation, cannot be permitted to raise the question of "fair and equitable" by a motion to vacate the final decree. To do so, would be to open the door to a stream of motions to vacate final decrees on the grounds of unfairness, by parties dissatisfied with the ultimate results. Petitioner had its day in court. (*In Re New Rochelle Coal & Lumber Co.*, 77 F. [2d] 881, 882 [C. C. A. 2nd].) This petitioner was afforded ample opportunity to be heard—but it chose to remain silent.

5. Since the rights of third parties have intervened, it would be inequitable to make a substantial change in the plan of reorganization at this late date.

The record shows that after the close of the reorganization $141,000. was paid into the treasury for necessary additional working capital; $45,569.35 was paid to the former creditors of the debtor to whom had been issued all the stock of the new corporation. In addition, the new corporation assumed the obligation to pay upwards of $39,000. to those of the former creditors who elected to take first preferred stock instead of cash.

One-half of the cash investment above referred to was made by two former creditors of the debtor and the balance by thirteen others, some of whom are relatives of those who formerly conducted the debtor's business. The cost to the new investors exceeded $225,000. (R. 39-41).

It is essential to note that this investment was made long after the case was closed and that it was made on the faith of the reorganization and in reliance upon the fact that the new company had not assumed the leases (R. 38). These facts are not disputed (R. 82).

Petitioner would have it that since some of the new investors are former creditors or relatives of those who formerly conducted the debtor's business, it would not be inequitable to make a substantial change in the plan of reorganization at this time.

There is little merit to this contention, unless it is shown that these new investors planned the sequence of events with intent to defraud petitioner. The court below found no such intent or scheme and nothing appears in the record which should disturb that conclusion. The District Judge, familiar with all the facts, weighed the equities and found that it would be inequitable to make any change in the plan to the prejudice of the new investors (R. 82).

The bankruptcy court has the power for good reason to revise its judgments on reasonable application before rights have vested on the faith of its actions. (*Wayne United Gas Co.* v. *Owens-Illinois,* 300 U. S. 131, 137.) Similarly in case of a discharge in bankruptcy the bankrupt will ordinarily engage in new business enterprises and persons may in good faith extend him credit in the belief that he has been discharged from pre-existing

debts, and their rights will be affected if the discharge is revoked. (*In re Oleson*, 110 F. 796, 798; *Narragansett Electric Co.* v. *Sabre*, 51 R. I. 37; *Marks* v. *Merrill Paper Co.*, 203 F. 16 [C. C. A. 7]; *National Broadway Bank* v. *Hitch*, 66 Hun 401, 21 N. Y. Supp. 395.)

Petitioner had notice of all proceedings. It had its day in court. It did nothing. The new investors put a very substantial sum of money into the new corporation to acquire its stock. They relied upon the order confirming the plan and upon the final decree. Judge Patterson rightly held:

> "It would be inequitable to make a substantial change in the plan of reorganization at this late day, to the prejudice of those who have invested new money in the interval" (R. 82).

CRITICISM OF SPECIFICATIONS OF ERRORS URGED BY PETITIONER.

As in its statement of the questions presented, petitioner's specifications of error are also based on false premises.

Specification (1) is, of course, a mere conclusion.

Specification (2) assumes that Judge Patterson did not know that the new corporation was not bound to assume leases under the amended plan, an assumption which we have heretofore shown to be unfounded. It assumes further that landlords holding unrejected leases were remediless which we have likewise shown and which the Circuit Court has held not to be so. It assumes, finally, that petitioner did not know "the true facts" and that it took diligent steps after such discovery, and before the

rights of third persons intervened, to remedy what it conceived to be the deficiency of the plan, none of which assumptions is justified by the record. In short, this specification of alleged error is predicated on error after error.

Specification (3) assumes that it was held that petitioner was bound by the plan solely because it received a copy. This is not the sole basis of the decisions of either the District or Circuit Courts. It further assumes that the plan did not apprise petitioner that its lease was not to be assumed by the new corporation. We have shown that such fact is apparent from the face of the plan.

Specification (4) obviously distorts the decision of the lower court into something foreign to its holding.

Specification (5) incorrectly assumes that there was an intent to prefer certain creditors over the petitioner, and seeks to draw a non-existent parallel between the *Kansas City Railway* case and the instant case.

Specification (6) is a flagrant example of petitioner's and not the court's error. Petitioner complains that the court should "at least" have vacated the stay contained in the order of June 30, 1939, which enjoined suits against the new corporation or any of the assets transferred to it by the debtor, without giving any reasons anywhere why the court should treat this case differently from any other.

Specification (7) urges as an error what we have shown to be well settled cannot be deemed an error, that is, that the re-opening of estates is addressed solely to the sound discretion of the District Court. The specification also urges as an error the holding that there was no abuse of discretion although the record is barren of a scintilla

of evidence indicating that Judge Patterson had abused his discretion.

Specification (8) reiterates the fallacious assumption that the Merchandise Creditors' Advisory Committee was guilty of a breach of trust and implies that that committee "obtained" approval of the plan, as if no one else had an opportunity to come in and object, although both the District and Circuit Courts have held that the petitioner, for one, had an opportunity to do so and remain silent, and that there was no unfair advantage taken by any creditor.

ANSWER TO PETITIONER'S STATEMENT OF REASONS FOR GRANTING THE WRIT.

We shall not encumber this brief by reiterating the facts and conclusions heretofore advanced to show that the writ should not be granted and that there is nothing in this case requiring a review by this court. We do, however, desire to answer briefly petitioner's recital of reasons why the writ should be granted (petition, pp. 16-24).

Petitioner continues its method of arguing from false premises. It begins (p. 16) by arguing that this is a novel case by assuming that the plan was deliberately framed to prefer one group of creditors over another, for which there is not the slightest basis in the record. It seeks to draw an analogy between this case and that of *Howard* v. *Maxwell Motor Car Co.*, a case which is not in point and which is based on the relationship between stockholders and creditors and arises from the equitable rights of the creditors as against stockholders.

> "Plaintiffs (Lessors), therefore, retained the right to *subject the interest of the old stockholders*

> in the property to the payment of their claim. If their interest is valueless, he gets nothing. If it be valuable, he merely subjects that which the law had originally and continuously made liable for the payment of corporate liabilities." (Italics ours.)
>
> 269 F., at p. 305.

In the case at bar the stockholders of the debtor were to and did receive nothing (R. 14).

Although this is a simple case involving solely a question of judicial discretion in refusing to reopen an estate, petitioner, in order to procure the writ, would transform this application into one of "far reaching importance in the field of reorganization law," involving the manoeuvering of landlords and even "other classes of creditors" out of any opportunity to participate in the avails of the reorganization, something which is without the slightest basis in the record and which the two courts below have held not to be the fact.

The question in this case is not at all as broad as stated by the petitioner (pp. 16-17), involving an alleged perversion of the processes of the District Courts. It is a question as to whether the District Court can possibly be charged with an abuse of discretion because it refused to re-open this estate, after the rights of third persons who relied on the closing thereof had intervened, at the instance of this petitioner who, as shown, appeared in the proceeding, waived its right to come in as a creditor, moved in the proceeding to compel the payment of rent, had notice of all proceedings, including that on confirmation of the plan as well as a copy of the plan, remained silent and failed to object to confirmation, saw the plan carried out and knew that new money was being invested by third persons.

Referring now briefly *seriatim* to the specific reasons advanced by petitioner (pp. 16-17) in support of the writ:

1. and 2. It would be a work of constant repetition to demonstrate in detail anew the fallacies which petitioner continues to reiterate and which we have heretofore shown to be without foundation. An examination of the cases cited under reason (1) (petition, p. 17) will show quite clearly that the holding of the court below not only does not conflict with these decisions but that they are not even applicable to the case at bar. For example, *Kansas City Railway Co.* v. *Guardian Trust Co.*, clearly refers, as petitioner itself states, to "an intent to prefer the stockholders and leave the unsecured creditors inadequately provided for." We have already shown that in the instant case there was neither an intent to prefer anyone nor was there any question as between creditors and stockholders. This distinction, which petitioner constantly overlooks, was stated quite clearly in *Fogg* v. *Blair*, 133 U. S. 533, 541; and *Oehring* v. *Fox Typewriter Co.*, 272 F. 833, 835 (C. C. A. 6). See also *Hollins* v *Brierfield Coal & Iron Co.*, 150 U. S. 371. Petitioner repeats the unjustified assumptions that the Merchandise Creditors' Advisory Committee purported to represent all the creditors, that it disobeyed the law and submitted a plan which it knew to be unfair, that there was nothing on the face of the plan that unrejected leases were not to be assumed by the new corporation, and that landlords, particularly petitioner, who had appeared throughout the proceeding and were apprised of all steps taken therein, had the right to assume that they were not to be affected by the plan. The language of these two paragraphs of the petition is loaded with erroneous assumptions.

3. *Linn Timber Co.* v. *United States* is completely inapplicable. There the court said:

> "We are considering whether a man who knows that his title is bad and will be attacked can call into being a corporation which he owns, in order to save the property, make a deed to it, put the deed in his pocket, leave it unrecorded, and without the need of trusting even an accomplice, can keep it with perfect security until the statute has run, and then set up that his creature owns the land. We are deciding that if a secret transfer of wrongfully held land is made in this way * * * the trick must fail."

Manifestly, this case has no application here. To the very same effect is *Wilson Coal Co.* v. *United States,* which likewise is inapplicable. Petitioner predicates a charge of fraud against the new investors solely because some of them are former creditors or relatives of those who formerly conducted the debtor's business. The court below found no evidence of an intent to defraud petitioner and that finding is fully supported by the record. We have already demonstrated the inapplicability of *Kansas City Railway* v. *Guardian Trust Co.* In *Hurd* v. *N. Y. & C. Steam Laundry Co.,* the assets of the debtor were transferred to another corporation which paid for the same in stock which was paid out to the stockholders of the old corporation without regard to creditors. It was distinctly a device intended to bar creditors. In such case the assets remain a trust fund which creditors may follow. *Wilson* v. *Aeolian Co.* is, for the same reasons, wholly inapplicable.

4. In order to avoid the risk of tedium, the most that it is necessary to say of this reason is that it consists of

numerous charges and is replete with characterizations such as illegality, railroading, sharp dealing and the like, none of which is substantiated by the record as we have heretofore demonstrated.

5. Aside from the fact that petitioner failed to object to or appeal from the confirmation of the plan which it now condemns and aside from the unjustified assumption that the petitioner was "effectively barred from participating in the reorganization through the mere failure to provide for him in the reorganization plan," the extract quoted from the article by Mr. Justice Douglas and Mr. Jerome N. Frank in 42 Yale Law Journal is wholly inapplicable to the case at bar. In its brief to the Circuit Court the petitioner said of this extract

> "This conclusion, these learned authors went on to say, 'follows from the general equitable principles enunciated in the *Boyd* case * * * and a long line of prior and subsequent decisions in the Supreme Court and in the lower Federal Courts.'"

The doctrine of the *Boyd* case (*Northern Pacific Ry.* v. *Boyd*, 228 U. S. 482) and related cases is inapplicable here. Those cases stand for the proposition that the stockholders of an insolvent corporation have no right or interest in the assets of the corporation; that the assets of such corporation belong to the creditors; that no plan of reorganization can be approved which gives any rights to stockholders, where such rights reduce the interests of the creditors in the assets. The theory upon which this doctrine rests is that, *so far as stockholders* are concerned, the property of the insolvent company is a trust fund for creditors and must first be appropriated to the payment of the debts of the company before any portion of it can be distributed to the stockholders. (*Fogg*

v. *Blair, supra.*) Thus, in the *Boyd* case the court said, in 228 U. S. at page 502:

> "For if such contract reorganization was consummated in good faith and in ignorance of the existence of the creditor, yet when he appeared and established his debt, *the subordinate interest of the old stockholders would still be subject to his claim in the hands of the reorganized company.*" (Italics ours.)

The trust, it is seen, is impressed upon the interest of the old stockholders, which was subordinate to the creditors' claims. What they received is held by them subject to the creditors' superior rights.

6. Aside from the fact that the opening statement of this reason misinterprets the meaning of the Circuit Court opinion, the *Consolidated Gas* case cited by petitioner is wholly inapplicable here. The facts in this case are so different that the *Consolidated* case cannot be treated as controlling or even applying to this case.

In that case the confirming order reserved for further determination the question of affirmance or rejection of executory contracts, with the proviso that in the event the contracts were later rejected, the court would determine what damages were caused by the rejection and would provide for payment thereof by the reorganized corporation.

The appeal was from the reservation in the confirming order of the right to later reject leases and pay damages. It must be noted, first, that this reservation as to the leases was not made in the plan of reorganization—but in the confirming order.

The court specifically stated that the question as to a reservation *in the plan itself* was not before it in that case. If creditors had accepted a plan which contained such reservation, it is difficult to see how any objections to such procedure could be raised. In the present case, the plan of reorganization plainly sets forth the disposition that was to be made of unexpired leases. This also distinguishes this case from the *Consolidated* case.

Second, the objection in the *Consolidated* case was that creditors assented to a particular plan, but by the reservation contained in the confirmation order this plan could be changed, in that, if the leases were later rejected, the interests of the creditors would be diminished to the extent that assets of the reorganized corporation would be used to pay the damages fixed on such rejection. Creditors would receive *less* than they consented to receive. This was the real defect in the *Consolidated* case. Such defect is not present here—but, to the contrary, that is exactly the result that would be obtained if petitioner were successful here. The entire plan would be so materially altered by compelling the new corporation to assume the leases, that creditors' assent to the amended plan would be required, (Bankruptcy Act, Sec. 222) and such procedure has been rendered impossible by the intervention of the rights of third parties who have invested new money in the corporation relying upon the plan and the order confirming it.

7. This reason begins with the erroneous assumption that the absence of actual fraud was the sole reason for the refusal of the Circuit Court to grant petitioner's application. A reading of the opinion of that court as well as the opinion of the District Court, whose determination is, in the last analysis, the basis of the present petition, will show that this is not so. We have

already shown that the cases cited in this reason are inapplicable here, and the remaining case cited, *In re Alamac Operating Corp.*, is likewise not in point. There again the stock of the new corporation went to the old stockholders and furthermore there was no evidence that the non-assenting creditor was cited so as to bind it, which in itself is sufficient to distinguish that case from the instant one. Petitioner reiterates its complaint (p. 23), on which we have already commented, that the District Court was in error in, consistent with its denial of petitioner's application to reopen the proceeding, "even" declining to allow petitioner to defeat the court's decision by refusing to allow it to proceed against the assets transferred to the new corporation.

We submit that there is no basis whatsoever for petitioner's reflection (p. 24) upon the decision of the Circuit Court to the effect that it limited its own power to redress "the wrong" to petitioner because of the absence of actual fraud. For reasons in addition to the absence of actual fraud, the Circuit Court did not see fit to reopen this estate, just as for similar broad reasons of discretion the District Court held likewise. We see nothing "undesirable" about these decisions.

We have heretofore shown that it would be undesirable if any party to a reorganization, finding itself in a position which it did not contemplate, or finding that it made a poor bargain, could later come in and vacate the final decree and amend the plan; that it would thus be dangerous to deal with reorganized corporations; and that it would be impossible to obtain new investments.

CONCLUSION.

It is respectfully submitted that the petition for a writ of certiorari should be denied.

Respectfully submitted,

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